

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
BANKERS TRUST NEW YORK CORPORATION	:	DETERMINATION
	:	DTA NO. 811316
for Redetermination of a Deficiency or for	:	
Refund of Franchise Tax on Banking Corporations	:	
under Article 32 of the Tax Law for the Years	:	
1984 through 1987.	:	

Petitioner, Bankers Trust New York Corporation, c/o Corporate Tax Department, P.O. Box 1703, Wall Street Station, New York, New York 10268, filed a petition for redetermination of a deficiency or for refund of franchise tax on banking corporations under Article 32 of the Tax Law for the years 1984 through 1987.

A hearing was commenced before Frank W. Barrie, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on April 16, 1993 at 10:00 A.M. and continued¹ to completion before Judge Barrie at the same location on October 22, 1993 at 9:15 A.M., with all briefs to be submitted by May 13, 1994. Petitioner's brief on one² of the two primary issues involved herein was filed on

¹By a motion dated April 14, 1993, petitioner sought to amend its petition to assert additional issues, which resulted in the continuation of the hearing. By an order dated August 19, 1993, the Administrative Law Judge permitted petitioner to amend its petition to raise the issue concerning the deduction of 17% of the interest received from indirect subsidiaries in the computation of entire net income.

²This initial brief addressed the issue concerning the deduction of 17% of the interest received from indirect subsidiaries in the computation of entire net income. By a motion dated February 14, 1994, petitioner had sought to sever the second main issue herein, concerning the exclusion of United States obligations and the interest therein in computation of entire net income and capital, and to stay adjudication of such issue pending the final determination of the action for declaratory judgment before the Supreme Court of the State of New York, County of Nassau, entitled Astoria Federal Savings and Loan Association v. State of New York et al (Index No. 93-006014) on the grounds that such issue was the subject of a motion for summary

February 14, 1994. The Division of Taxation's brief was received on March 22, 1994. Petitioner's reply brief, which addressed the issue concerning the deductibility of 17% of the interest received from indirect subsidiaries, was received on April 25, 1994. A supplemental reply brief concerning the exclusion of United States obligations and the interest thereon was filed on May 13, 1994. Petitioner appeared by Hutton & Solomon, Esqs. (Stephen L. Solomon and Kenneth I. Moore, Esqs., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (John O. Michaelson, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation treated obligations of the United States in a discriminatory fashion because bonds (and interest earned thereon) of the New York City Municipal Water Finance Authority were

exempted from franchise taxes so that petitioner should be entitled to a refund of franchise taxes because it filed tax reports which included interest from Federal obligations in the measurement of its entire net income for each of the years at issue and, for the years 1985 through 1987, it included the value of Federal obligations in the measurement of its taxable assets.

II. Whether, if petitioner prevails on Issue I, the Division may exclude expenses indirectly attributable to interest income from Federal obligations as computed by its auditor who used a ratio which compared petitioner's interest income from Federal obligations to total income and

judgment then pending in the Supreme Court action. Petitioner maintained that the 1991 amendment to Public Authorities Law § 1045-u.3, which made it clear that New York City Municipal Water Finance Authority bonds (and the interest thereon) have always been subject to indirect taxation such as franchise taxes, was unconstitutional. Since the constitutionality of such section, as amended, must be presumed by the Administrative Law Judge, petitioner contended that this administrative proceeding should be stayed as to such issue. With its motion papers, petitioner submitted a copy of the Astoria Federal Savings and Loan Association's brief in support of its motion for summary judgment. (Petitioner's representative was also Astoria's representative.) By an order dated April 29, 1994, the Administrative Law Judge denied petitioner's motion to sever and stay and permitted petitioner to submit a supplemental reply brief.

then applied such ratio to petitioner's total interest expenses and total deductions.

III. Whether petitioner may properly deduct 17% of the interest received from indirect subsidiaries in computing its entire net income.

IV. Whether the Administrative Law Judge has the authority to determine whether the Division of Taxation violated the secrecy provisions of Tax Law § 1467(a) by using excerpts from the hearing transcript in this matter as well as copies of documents introduced into evidence at the administrative hearing in the declaratory judgment action filed by the plaintiff, Astoria Federal Savings and Loan Association, in State Supreme Court and, if so, whether such secrecy provisions were violated.

V. Whether Issue IV was improperly raised by petitioner in its supplemental reply brief by its attachment of five letters to such brief after the hearing record had been closed to additional evidence.

VI. Whether the arguments set forth in Astoria Federal Savings and Loan Association's brief in support of its motion for summary judgment in State Supreme Court, which addressed aspects of Issue I, may be considered herein.

VII. Whether petitioner properly submitted its complete Federal tax returns and various acquisition reports and certifications concerning its ownership of certain indirect subsidiaries after the close of the hearing.

FINDINGS OF FACT

A Registration Statement (Form S-3), which petitioner, Bankers Trust New York Corporation, filed with the Securities and Exchange Commission on October 29, 1987, included the following description of petitioner and its banking operations:

"The Corporation is a bank holding company, incorporated under the laws of the State of New York in 1965. The Corporation's principal subsidiary is Bankers Trust Company ('Bankers'). At June 30, 1987, the Corporation had consolidated assets of \$54.7 billion, of which Bankers accounted for approximately 91%.

"Since 1980, the Corporation has disposed of its upstate New York banking operations, most of the Metropolitan New York branch office network of Bankers and its credit card operations in order to concentrate its financial and managerial resources on selected wholesale markets. In so concentrating its resources, under the name of merchant banking the Corporation has combined the on-balance-sheet

capability and service breadth of a commercial bank with the intermediary skills and entrepreneurial spirit of an investment bank.

"Bankers, founded in 1903, was the sixth largest among commercial banks in New York City and the seventh largest in the United States based on total assets of \$54 billion at December 31, 1986.

"Bankers' worldwide resources are concentrated on merchant banking for corporations, governments, financial institutions and high-net-worth individuals. The core business organizations of Bankers are Financial Services and PROFITCo. Financial Services consists of Corporate Finance, Global Markets and Investment Banking. PROFITCo. is comprised of Fiduciary and Securities Services, Investment Management, Private Clients Banking and Global Operating and Information Services.

* * *

"The Global Markets Function has responsibility for the business lines which are involved with markets, risk management and the funding of the Corporation worldwide. These include primary dealer operations in the securities of the U.S. Government and its agencies

* * *

"The Corporation is a legal entity separate and distinct from its subsidiaries, including Bankers. There are various legal limitations governing the extent to which the Corporation's banking subsidiaries may extend credit, pay dividends or otherwise supply funds to the Corporation or certain of its other subsidiaries. The rights of the Corporation to participate in any distribution of assets of any subsidiary upon its liquidation or reorganization or otherwise (and thus the ability of holders of the Common Stock to benefit indirectly from such distribution) are subject to the rights of those with prior claims on that subsidiary, except to the extent that the Corporation may itself be a creditor of that subsidiary . . ." (emphasis added).

Petitioner filed combined³ New York State franchise tax returns for banking corporations (Forms CT-32) for each of the years at issue including interest from Federal obligations in the measurement of its entire net income as follows:

<u>Year</u>	<u>Interest from Federal Obligations Reported</u>
1984	\$102,325,337.00
1985	140,743,980.00
1986	125,156,443.00
1987	76,527,382.00

For the years 1985 through 1987, petitioner deducted 22.5% of the interest from Federal

³The complex returns of petitioner, a bank holding company, covered over 60 affiliated companies.

obligations which it held for investment pursuant to Tax Law § 1453(e)(12)⁴ as follows:

<u>Year</u>	Amount of <u>Deduction</u>
1985	\$2,153,790.00
1986	4,347,005.00
1987	6,435,674.00

For the years 1985 through 1987, in calculating its taxable assets, petitioner included the value of its Federal obligations as follows:

<u>Year</u>	Value of Federal Obligations Included in Taxable Assets
1985	\$1,664,211,000.00
1986	2,015,174,000.00
1987	1,203,478,000.00

The parties agreed that this matter will serve as "one lead case", in the words of attorney Moore in his letter of February 2, 1994 to Daniel J. Ranalli, Assistant Chief Administrative Law Judge, with regard to the issue concerning the exclusion of United States obligations and the interest thereon in computation of entire net income and capital. The following ten matters were placed on hold pending resolution of this matter:

Astoria Federal Savings and Loan	DTA# 811306
Long Island Savings Bank FSB	DTA# 811792
Sterling Bancorp and Subsidiaries	DTA# 811793
Sunrise Federal Savings and Loan	DTA# 811552
Bank of New York Co.	DTA# 811771
Bank of New York Co. (Irving Trust Co.)	DTA# 811772
Gouverneur Savings and Loan	DTA# 811773
Hamilton Savings and Loan	DTA# 811774
Hudson Valley Holding Corp.	DTA# 811775
Donaldson Lufkin and Jenrette	DTA# 812167

Petitioner filed four timely claims for refund of franchise tax on banking corporations on

⁴Tax Law § 1453(e)(12) was added by Laws of 1985 (ch 298, § 18, eff July 10, 1985, retroactive to taxable years beginning on or after January 1, 1985). It provides a deduction in determining entire net income for:

"twenty-two and one-half percent of interest income on obligations of New York state, or of any political subdivision thereof, or of the United States, other than obligations held for resale in connection with regular trading activities [i.e., for obligations held for investment]" (emphasis added).

forms CT-8, Claim for Credit or Refund of Corporation Tax Paid, as follows:

Date of Signing of Refund <u>Claim</u>	Year at <u>Issue</u>	Amount of Refund <u>Claim</u>	Basis Stated for Refund Claim on <u>Form</u>
October 12, 1990	1984	\$ 3,136,413.00	(1) Tax impermissibly discriminated against obligations of the United States Government and the interest on such obligations so that such obligations and the interest thereon should be excluded from the measure of the tax.
December 15, 1990	1985	\$ 38,895.00	(1) Same basis as "1" for the 1984 year; (2) Subtraction correction regarding the 22½% deduction for interest earned on New York State municipal securities; and (3) Inclusion of a subtraction for 17% of the interest earned on subsidiary capital.
December 15, 1990	1986	\$11,146,380.00	(1) Same basis as "1" for the 1984 and 1985 years plus (2) Subtraction correction regarding the 22½% deduction for interest earned on New York State municipal securities.
March 7, 1991	1987	\$12,759,828.00	(1) Same basis as "1" for all of the earlier years.

By a letter dated October 31, 1990, the Division of Taxation ("Division") denied petitioner's refund claim for 1984. No explanation for the denial was provided in this letter.

By a letter dated March 8, 1991, the Division denied petitioner's refund claims for 1985 and 1986. This letter referenced the claims dated December 15, 1990 described in Finding of Fact "4". It also referenced a refund claim dated November 19, 1990 for 1985, 1986 and 1987 with reference to an issue described as "IBF eligible net income (loophole)". (A copy of the refund claim dated November 19, 1990 was not made a part of the record.) The following

explanation for the denial was provided:

"You [sic] claims are being respectfully denied for the following reasons:

"(1) As you know, we do not recognize the loophole issue

"(2) Under Tax Law Section 1453(e)(11)(i), a deduction for 17% of interest received from subsidiary capital is allowed. This deduction is only allowed for interest from 1st tier subs. Since the interest you are claiming is from other than 1st tier subs, the deduction will not be allowed.

"Tax Law Section 1453(b)(1) requires the addback of any income exempt from Federal taxable income. Interest income from U.S. Government obligations must be added back to FTI each year.

* * *

". . . It is not clear in your claim what [the amounts claimed for the 22.5% deduction and corrections to IBF eligible net income] are from, or if they have already been addressed on audit."

By a letter dated January 29, 1992, the Division denied petitioner's refund claim for 1987 and provided the following explanation:

"[T]he interest on bonds issued pursuant to Title 8A of Article 5 of the Public Authorities Law is included in entire net income. Therefore, New York does not discriminate in its treatment of obligations issued by the State or its local municipalities and your refund claim for \$3,786,914.00⁵ . . . is respectfully denied."

Included in petitioner's Exhibit "5", an affidavit dated April 9, 1993 of William F. Collins, Deputy Commissioner and Counsel of the Department of Taxation and Finance, is a photocopy of a letter dated October 2, 1990 on the letterhead of petitioner's attorneys to an officer of the New York League of Savings Institutions. This letter solicited "savings institutions which included the income or capital attributable to U.S. obligations in the computation of the State or City franchise taxes" to file refund claims with the attorneys'

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As noted in Finding of Fact "4", petitioner's refund claim for 1987 was for \$12,759,828.00. This variation was not explained, although marked into evidence as petitioner's Exhibit "2" was a computation of revised tax which the parties agreed "would be an accurate reflection of . . . Petitioner's claim for refund attributable to the U.S. obligations [aside from the attributions of expenses as further discussed in Finding of Fact "10"]." Exhibit "2" shows amounts claimed for refund attributable to U.S. obligations as \$4,004,133.00 for 1987, \$6,413,829.00 for 1986, \$38,895.00 for 1985, and \$3,136,413.00 for 1984.

assistance because "in recent years the City and State taxes have become discriminatory, since numerous New York State and City obligations are treated more favorably than U.S. government obligations." According to Mr. Collins' affidavit, "the Department became aware of the differences in interpretation of certain sections of the Public Authorities Law . . . [as] the result of [such] correspondence from the law firm of Hutton & Solomon to various banks" Consequently, the Division's Technical Services Bureau issued a memorandum dated December 18, 1990, TSB-M-90-(14)C, which noted that the bonds or the interest on the bonds issued under 1984 legislation known as Title 8-A of Article 5 of the Public Authorities Law, "The New York State Local Water and Sewer Authority Act", were not exempt from franchise taxes. The Division's memorandum interpreted the 1984 legislation, Public Authorities Law § 1196-1(3),⁶ to mean the exemption from franchise taxes "refers to

and modifies the exemption from taxation of activities of the Authority but not the bonds or the interest from the bonds of the Authority."

Deputy Commissioner Collins testified that he personally researched the intent behind the 1984 legislation as a result of his:

"[trying] to figure out where this argument may have sprung from that Mr. Solomon was spreading Several bank people, as I recall, called the Commissioner and asked what was the Commissioner's intention here. Were they going to be embarrassed by not joining the lawsuit or such a lawsuit" (tr., p. 117).

Mr. Collins discovered "no intention [with the 1984 legislation] to change the breadth of the initial exemption" for bonds issued by public authorities (tr., p. 119).

⁶The same language is found in the original versions of the specific sections of the Public Authorities Law relating to the following local authorities: Green Island Power Authority, § 1020-m; New York City Municipal Water Finance Authority, § 1045-u; Buffalo Municipal Water Finance Authority, § 1048-u; Albany Municipal Water Finance Authority, § 1115-t; Town of Clifton Park Water Authority, § 1120-n; Water Authority of Great Neck North, § 1197-m; Water Authority of Western Nassau County, § 1198-n; Rensselaer County Water and Sewer Authority, § 1199-n; Wayne County Water Authority, § 1199-nn; Orange County Water Authority, § 1199-oo; Saratoga County Water Authority, § 1199-nnn; Greater Utica Area Water Finance Authority, § 1226-m.

Nonetheless, Deputy Commissioner Collins testified:

"We decided collectively in the Executive Branch, [i.e.] Governor's Counsel, Division of Budget and we in the Department [of Taxation and Finance], that it would be desirable to correct the language of those provisions so that the intent would be absolutely clear in the nature of a technical correction" (tr., p. 134).

As a result, in 1991, the statutory language at issue was amended to clearly provide that the bonds (and interest income thereon) of the New York City Municipal Water Finance Authority and similar entities were not exempt from franchise taxes.

Commencing in or about November 1985, bonds were issued by the following New York public authorities pursuant to the statutory language at issue as follows:

New York City Municipal Water Finance Authority

<u>Series:</u>	<u>Amount of Issue:</u>	<u>Dated:</u>
1986-A	\$ 200,000,000.00	11/1/85
1986-B	200,000,000.00	4/1/86
1987-A	388,650,000.00	1/15/87
1987-B	160,278,231.45	6/1/87
1988-A	244,915,000.00	10/1 or 10/14/87
1988-B	245,000,454.95	3/1 and 3/30/88
1989-A	275,001,169.50	11/3/88
1989-B	288,057,995.20	3/28/89
1990-A	281,474,424.50	12/13/89
1991-A	285,000,004.00	8/16/90
1991-C	354,610,000.00	2/28 or 3/7/91
1992-C	200,000,000.00	6/25/92
1993-A	1,040,704,592.35	8/13/92
1993-B	125,000,000.00	10/15/92
1993-C	100,000,000.00	10/15/92

Albany Municipal Water Finance Authority

<u>Series:</u>	<u>Amount of Issue:</u>	<u>Dated:</u>
1988-A	\$ 46,700,000.00	1/1/88

Great Neck North Water Authority

<u>Series:</u>	<u>Amount of Issue:</u>	<u>Dated:</u>
1989-A	\$ 18,170,000.00	12/1/89

Domenick Sciortino, Director of the Division's Corporation Tax Audit Bureau, testified that approximately 800 banks file franchise tax returns and that, over a three-year cycle, virtually all of them are audited (tr., p. 78). His testimony also confirmed the following statement in his affidavit of April 1993 (Division's Ex. "D" [which did not specify a particular day in April]):

"As the Director of the Corporation Tax Audit Bureau I am intimately aware of the tax policies of the Department. It is the regular business practice of the Department to treat all income from federal and state obligations equally. The income from both types of obligations are subject equally to New York State income or franchise tax. There has never been any policy of the Department to exclude the income from any state obligation, nor is there such a policy at the present time."

Expenses Indirectly Attributable to Interest Income

The Division contended that if petitioner is permitted to exclude (i) interest from Federal obligations in the measurement of its entire net income and (ii) the value of Federal obligations in the measurement of its taxable assets, expenses (including interest expense and deductions) indirectly attributable to interest income from such Federal obligations should also be excluded. John Verde, the Division's auditor, testified concerning his methodology for calculating expenses indirectly attributable to interest income. He used a ratio consisting of petitioner's interest income from Federal obligations divided by petitioner's total income. For example, he computed a ratio of 1.6789% for 1984 based upon interest income from Federal obligations for 1984 of \$102,242,793.00 divided by total income for such year of \$6,089,704,058.00. This ratio of 1.6789% was then applied to interest expense of \$4,885,607,135.00 and total deductions of \$5,917,354,572.00 to calculate interest expense attributable and deductions attributable of \$82,026,666.00 and \$99,349,140.00, respectively. According to the auditor, such amounts should be disallowed as deductions if interest income from Federal obligations is excluded. Similar calculations were performed for each of the other three years at issue and were summarized in the Division's Exhibit "C".

Harry Montgomery, a vice-president of petitioner and the managing director of its tax department, testified that out of petitioner's 8,600 employees in the United States during 1985, fewer than 10 people dealt with investments in Federal obligations. Furthermore, Mr. Montgomery testified that petitioner did not incur interest specifically to purchase Federal obligations:

"Most of our interest expense is as a result of the bank's interest expenses, primarily, a result of deposits, period" (tr., p. 187).

Interest from Indirect Subsidiaries

Petitioner claims that it is entitled to a deduction for 17% of the interest income earned from the following subsidiaries, as noted in its Exhibit "12", for each of the years 1985 through 1987⁷ as follows:

Name of <u>Subsidiary</u>	<u>1985</u>	<u>Interest Received</u> <u>1986</u>	<u>1987</u>
Bankers Trust Holding (U.K.) Ltd.	\$ 64,769,000.00	\$109,372,000.00	\$ 89,140,000.00
Bankers Trust (France) S.A.	6,932,000.00	20,276,000.00	34,212,000.00
B T Asia Limited	27,499,000.00	24,979,000.00	11,542,000.00
Bankers Trust GmbH	28,920,000.00	49,261,000.00	55,988,000.00
B.T. Australia Limited	2,954,000.00	4,331,000.00	19,194,000.00
Bankers Trust International (Asia) Ltd.	371,000.00	3,781,000.00	2,693,000.00
Malta Properties Ltd.	579,000.00	2,306,000.00	4,471,000.00
BT Servicios Financieros S.A.	-0-	-0-	897,000.00
Bankers Trust A.G.	4,550,000.00	1,608,000.00	1,082,000.00
Bankers Trust Finanziaria S.p.A.	332,000.00	379,000.00	150,000.00
Bankers Trust Company International	559,000.00	282,000.00	54,000.00
BT Bank of Canada	-0-	-0-	5,000.00
BT Foreign Investment Corp.	<u>1,066.00</u>	-0-	-0-
Total Interest Received	\$138,531,000.00	\$216,575,000.00	\$219,428,000.00

Although Mr. Montgomery testified that the amounts shown as interest received came from petitioner's books and records, such books and records were not "brought" to the hearing (tr., p. 216).

Mr. Montgomery testified that "[t]here's no question in my mind" that Bankers Trust Company, petitioner's principal subsidiary as noted in Finding of Fact "1", owns and controls the subsidiaries listed in Finding of Fact "13" by virtue of a "chain of ownership" (tr., p. 215). However, petitioner offered little evidence concerning the operations and nature of its subsidiaries, directly or indirectly owned. A close review of Exhibit

"11" (described as a "true copy of the field audit report") to the stipulation between the parties dated April 16, 1993 discloses a listing of 108 subsidiaries. Only three of the subsidiaries listed

⁷Tax Law § 1453(e)(11)(i), which allows a deduction for 17% of the interest received from subsidiary capital, was enacted by Laws of 1985 (ch 298, § 18, eff July 10, 1985, retroactive to taxable years beginning on or after January 1, 1985).

in Finding of Fact "13" are included: BT Bank of Canada, described as a Canadian bank not included in petitioner's New York combined return because it is "Non NY, No Interco. or improper agreement"; BT (Bankers Trust, presumably) Company International, whose activities are described as financial services and which also was not included in petitioner's New York combined return because it is "Non NY No Interco no improper agreement"; and Malta Properties, a real estate bank, not included because it is "Non NY, No Interco No Improper Agreement." It is not clear why the other 10 subsidiaries listed in Finding of Fact "13" are not included in this listing of 108 subsidiaries. Although somewhat speculative, it may be due to the fact that on the chain of ownership they are more distantly related to petitioner. In any event, the lack of explanation exemplifies the minimal information provided by petitioner concerning the 13 subsidiaries listed in Finding of Fact "13".

Petitioner reserved the right to introduce additional documents into the record after the close of the hearing to establish petitioner's chain of ownership over these subsidiaries described as follows:

Attorney Abitbol:⁸ "After consultation with my colleagues and some telephone calls, we decided that the best thing to do would be to submit a certified copy of the stock, the record of stock ownership from each of the companies listed

in . . . the schedule, Petitioner's 13, demonstrating the chain of ownership" (tr., p. 229).

Documents Submitted After the Hearing

Petitioner, by a letter dated November 30, 1993, described the documents it submitted (on that same date) to establish ownership of the subsidiaries listed in Finding of Fact "13" as follows:

"1. The taxpayer's original books and records with respect to stock ownership of its subsidiaries are, in fact, electronic, and are kept on a database in a

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R. Gordon Abitbol is an attorney associated with Hutton & Solomon. Although his name does not appear on the power of attorney appointing Messrs. Moore and Solomon as petitioner's attorneys, petitioner's officer, Martin Linzer, who was present at the hearing, expressly approved of Mr. Abitbol's participation at the hearing.

computer. The raw data contained in such database and the reports generated thereby are used by the taxpayer in tax reports and filings, submissions to various State and federal regulatory agencies, etc. Rather than presenting the Court with the raw data concerning stock ownership, which cannot be easily or concisely extracted from such database in a meaningful or easily-understood manner, we have taken the liberty of presenting the Court with reports setting forth the applicable information, i.e., the name of the subsidiary; the total shares of such subsidiary outstanding as of certain dates critical to this proceeding; the name of the entity that owns such subsidiary's shares; the amounts and dates such shares were acquired, as well as the nature of such acquisition; and a figure representing the total equity ownership. The accuracy of the data is certified by both Jeffrey Bardos, an officer of the taxpayer and the person principally responsible for maintaining the database, who asserts that the data used in the reports accurately reflects that contained in such database; and by Harry Montgomery, who testified on this issue at the October 22, 1993, hearing. Such certifications appear in the front of the binder.

"2. The binder is arranged as follows: the first page is merely a copy of Petitioner's Exhibit '12,' which serves more or less as a Table of Contents. The first page of each tabbed section is a copy of the page of Petitioner's Exhibit '13' that relates to the particular subsidiary. Behind that page is arranged (by year, if applicable) the above-mentioned reports detailing the chain of ownership, starting with the 'bottom-most' subsidiary and proceeding upwards to Bankers Trust Company, the wholly-owned subsidiary of the taxpayer."

A close review of the first "tabbed section" concerning BT Holdings (U.K.) Ltd., as an example, discloses the following. The first page shows a chain of ownership of petitioner owning 100% of Bankers Trust Co., which, in turn, owns 100% of Bankers International Corp., which, in turn, owns 100% of BT Holdings (Europe) Limited, which, in turn, owns 100% of BT Holdings (U.K.) Ltd. The next nine pages are so-called "acquisition reports". The first acquisition report pertains to Bankers Trust Holdings (U.K.) Ltd. as of December 31, 1985 and is in the following format:

"Company Name: Bankers Trust Holdings (U.K.) Ltd.
Total Shares Outstanding: 182,999,900 as of Dec. 31, 1985
Owners Name: BT Holdings (Europe) Limited

Date of <u>Acq.</u>	<u>Type</u>	Number of <u>Shares</u>
December 22, 1983	Transfer	44,666,837
December 22, 1983	Capital Increase	<u>138,333,063</u>
Total		182,999,900
	Equity Ownership	100%"

The second acquisition report also pertains to Bankers Trust Holdings (U.K.) Ltd., updated to

December 31, 1986 and shows changes in stock ownership during 1986, in addition to restating the earlier 1983 entries, as follows:

<u>"Date of Acq.</u>	<u>Type</u>	<u>Number of Shares</u>
December 22, 1983	Transfer	44,666,837
December 22, 1983	Capital increase	138,333,063
August 31, 1986	Share reduction	(164,699,900)
October 14, 1986	Stock dividend/new issue	10,000,000
December 29, 1986	Stock dividend/new issue	<u>51,020,408</u>
Total		79,320,408
	Equity Ownership	100%"

The third acquisition report also pertains to Bankers Trust Holdings (U.K.) Ltd., updated to December 31, 1987. This report shows no changes in stock ownership during 1987 and recaps the entries shown on the 1986 report. The next three acquisition reports pertain to BT Holdings (Europe) Limited as of December 31, 1985, December 31, 1986 and December 31, 1987, respectively. Each shows the owners as Bankers International Corporation with equity ownership of 100%. The only entry on each of the reports is as follows:

<u>Date of Acquisition</u>	<u>Type</u>	<u>Number of Shares</u>
December 8, 1983	Original cost or capital	1,000

The final three acquisition reports in the first tabbed section concerning BT Holdings (U.K.) Ltd. pertain to Bankers International Corporation. Each show the owner as Bankers Trust Company with equity ownership of 100%. Each report shows the same entries:

<u>Date of Acquisition</u>	<u>Type</u>	<u>Number of Shares</u>
February 28, 1960	Original cost or capital	100,000
January 31, 1963	Capital increase	<u>150,000</u>
Total		250,000

Petitioner also submitted on November 30, 1993 "true copies of the complete federal tax returns of the taxpayer for the years 1985, 1986 and 1987" (emphasis in original). Petitioner's representative described his reason for submitting these returns, which consist of three large cartons containing a couple thousand pages, as follows:

"Upon reviewing the transcript and conferring with the client, we determined that

the copies of such returns submitted into evidence by the Division of Taxation, as part of Exhibit B, were not, in fact, complete copies as filed with the Internal Revenue Service. For the sake of completeness, we are submitting the complete returns. We have consulted with John O. Michaelson, Esq., counsel for respondent, in this matter, who indicated that he has no objection to the complete returns becoming part of the official record" (emphasis added).

However, Mr. Michaelson, by a letter dated December 8, 1993 to the Administrative Law Judge, denied such consent:

"Recently, I received several large boxes of documents that the petitioner is attempting to submit into evidence. Frankly, I was surprised at the petitioner's attempt to submit additional evidence into the record at this late date. This ploy is an attempt to place the Division at a severe disadvantage and is contrary to the Rules of Practice of the Tax Appeals Tribunal.

"The petitioner is attempting to submit a number of affidavits [certifications], several tax returns [the complete Federal tax returns] and a summary prepared by the petitioner which describes the alleged stock ownership of various corporations. The documents being submitted do not include the one thing that the record was kept open for namely, certified copies of the record of stock ownership.

"The Division is being denied its procedural due process rights because we will not be able to cross examine the affiants on the subject matter of the affidavits. Further, we are unable to object on the record to the offer of this new evidence.

"In your closing summary of October 22, 1993, you stated that the record was being kept open for just one reason; to allow for 'the submission of the certified copies of the record of stock ownership.' Your summary goes on to state '[a]ny briefs or other documents not filed in accordance with this schedule will be returned to the party that filed them.' We request that these additional documents be returned to the petitioner and not be considered in your deliberations."

By a letter dated May 13, 1994, petitioner filed its "supplemental reply brief" in accordance with the Administrative Law Judge's order of April 29, 1994, as noted in footnote

"2". Petitioner appended the following correspondence to this final brief:

<u>Date of Letter</u>	<u>Writer</u>	<u>Addressee</u>	<u>Subject</u>
April 5, 1994	Attorney Abitbol	Assistant Attorney General Carol Fiske	Attorney Fiske's use of (1) affidavits of Domenick R. Sciortino and of William Collins, marked as exhibits in this matter, (ii) an excerpt of the hearing transcript and (iii) Astoria's own Tax Appeals petition in her motion papers and brief in the <u>Astoria Federal</u>

Savings & Loan
Association
declaratory judgment
action allegedly
violated the secrecy
provisions of Tax Law
§§ 202 and 1467.

April 7, 1994

Assistant A.G. Fiske

Attorney Abitbol

Tax Department denies
violation of secrecy
provisions.

April 18, 1994	Attorney Abitbol	Karl Felsen, Records Access Officer for Dept. of Taxation and Finance	Requests copy of full transcript of hearing held in this matter on April 16, 1993 and encloses check in payment.
April 28, 1994	Roberta Moseley Nero, Secretary to the Tax Appeals Tribunal	Attorney Solomon	Transcript will not be provided to Attorney Abitbol because he is not an authorized representative of Bankers Trust.
April 29, 1994	Karl Felsen	Attorney Abitbol	Transcript will not be provided because petitioner's representatives, "Messrs. Hutton and Moore stated that Bankers Trust did not want to waive any confidentiality"

In footnote "1" of its supplemental brief, petitioner gave the following reason for including the above correspondence in its brief:

"In response to the summary judgment motion filed by the plaintiff, Astoria Federal Savings & Loan Association ('Astoria') in the declaratory judgment action, the Department filed a cross-motion for summary judgment. Attached to this cross-motion as evidentiary exhibits were copies of documents introduced as evidence at the administrative hearing of BTNY, along with excerpts from the hearing transcript itself.

* * *

"This unlawful and unauthorized disclosure must not be condoned. BTNY believes that, aside from the violation of the secrecy provisions of the Tax Law, it is patently improper for one party to a pending administrative proceeding to publicly disclose the testimony and evidence submitted therein without the knowledge and permission of this tribunal and the taxpayer involved. This tribunal took steps on more than one occasion during the hearing to ensure BTNY's privacy, which has now been destroyed by the unilateral acts of the Department and the Attorney General."

By a letter received May 31, 1994, Mr. Michaelson requested that the above-described correspondence be returned to petitioner's representative and that the brief which petitioner filed in the declaratory judgment action of Astoria Federal Savings & Loan Association, which was submitted with its motion papers as noted in footnote "2", not be considered.

The parties executed a stipulation dated April 16, 1993 (Division's Ex. "B"), relevant portions of which have been incorporated herein.

SUMMARY OF THE PARTIES' POSITIONS

As noted in footnote "2", petitioner concedes that the constitutionality of Public Authorities Law § 1045-u.3, as amended in 1991, must be presumed since the Division of Tax Appeals lacks jurisdiction to determine the constitutionality of a statute on its face. Furthermore, petitioner rejects the Division's argument that expenses indirectly attributable to interest income from Federal obligations should be excluded if it succeeds in excluding interest from Federal obligations in the measurement of its entire net income and the value of such obligations in the measurement of its taxable assets.

Petitioner, citing Matter of The Racal Corporation and Decca Electronics (Tax Appeals Tribunal, May 13, 1993), argues that it had "beneficial ownership" of the 13 indirect subsidiaries listed in Finding of Fact "13" so that it may properly deduct 17% of the interest income earned from such subsidiaries.

The Division maintains that under Public Authorities Law § 1196-1(3), as clarified by amendment in 1991, interest income from the water and sewer bonds at issue is included in measuring New York franchise taxes. The constitutionality of this statute "is not a claim properly justiciable before the New York State Division of Tax Appeals or Tax Appeals Tribunal" (Division's brief, p. 11). However, if petitioner is allowed to exclude interest income from Federal obligations from its entire net income and the value of such obligations in the measurement of its taxable assets, under Tax Law § 1462(g), deductions directly and indirectly attributable to income from Federal obligations should be excluded.

The Division argues that petitioner has not established that it controls all aspects of the indirect subsidiaries listed in Finding of Fact "13" so that Matter of Racal Corporation and Decca Electronics (*supra*) is inapplicable.

CONCLUSIONS OF LAW

A. The Tax Appeals Tribunal has consistently held that once a hearing is completed,

additional evidence should not be admitted (see, Matter of A & J Auto Repair Corp., Tax Appeals Tribunal, May 6, 1993). The Division contests the submission, after the hearing was completed, of petitioner's complete Federal tax returns consisting of a couple thousand pages in three large cartons. As noted in Finding of Fact "16", the Division's representative denied the statement in the letter of petitioner's representative, which transmitted such returns, that he had no objection to the submission of the complete returns. Consequently, since the Division's representative did not consent to the submission of such returns after the hearing was concluded and petitioner had not obtained permission to submit them before the close of the hearing, they will not be included in the administrative record.

The Division also contests petitioner's submission of the affidavits or certifications and the summary of stock ownership as noted in Finding of Fact "15". However, such documents, which are described in detail in Finding of Fact "15", are close enough to the description of the documents which petitioner reserved the right to introduce into the record after the close of the hearing, as noted in Finding of Fact "14", that they will be included in the administrative record. Therefore, the blue binder containing the reports and certifications described in the transmittal letter dated November 30, 1993 will be marked into evidence as petitioner's Exhibit "14".

B. In its supplemental reply brief filed on May 13, 1994, petitioner attached correspondence as detailed in Finding of Fact "17". Such correspondence was submitted to assert petitioner's claim that the Division had violated the secrecy provisions of Tax Law § 1467(a) which provides, in part, as follows:

"Except in accordance with the proper judicial order or as otherwise provided by law, it shall be unlawful for the commissioner of taxation and finance, any officer or employee of the department of taxation and finance . . . to divulge or make known in any manner the amount of income or any particulars set forth or disclosed in any return required under this article. The officers charged with the custody of such returns shall not be required to produce any of them or evidence of anything contained in them in any action or proceedings in any court, except on behalf of the state or the commissioner of taxation and finance in an action or proceeding under the provisions of this chapter or in any other action or proceeding involving the collection of a tax due under this chapter to which the state or the commissioner of taxation and finance is a party or a claimant or on behalf of any party in an action or proceeding under the provisions of this article when the returns or facts shown thereby are directly involved in such action or proceeding, in any of which events the court may require the production of and may admit in

evidence so much of said returns or the facts shown thereby as are pertinent to the action or proceeding and no more."

First, it is observed that petitioner raised this serious issue in a fashion that did not provide the Division with a formal means to respond, which would have been provided to the Division if petitioner had proceeded by motion. Moreover, the more appropriate forum for resolving this matter would seem to be the court in which the documents were allegedly used in violation of the secrecy provisions. In any event, the Division of Tax Appeals would not have the jurisdiction to provide a remedy if, in fact, these provisions had been violated. The penalty specified in Tax Law § 1467(b) is not enforceable by the Division of Tax Appeals, whose powers are specified by statute and do not extend to the imposition of penalties for the violation of secrecy provisions by employees of the Division (see, Tax Law § 2006).

C. As noted in Conclusion of Law "D", the Division of Tax Appeals lacks jurisdiction to review the constitutionality of a statute on its face. Consequently, the arguments set forth in Astoria Federal Savings and Loan Association's brief, which addressed aspects of Issue I, are academic herein. Nonetheless, it was reasonable for petitioner to include such brief in its motion papers as noted in footnote "2". Consequently, the Division's argument that the arguments set forth in such brief should not be considered is rejected.

D. Turning to the first substantive issue, it is noted that petitioner's arguments concerning the constitutionality of Public Authorities Law § 1045-u.3, as amended in 1991, may not be addressed given the lack of jurisdiction of the Division of Tax Appeals to determine the constitutionality of a statute on its face (see, Matter of Unger, Tax Appeals Tribunal, March 24, 1994). Public Authorities Law § 1045-u.3, as amended in 1991, provides as follows with regard to the exemption from taxes, assessments and certain fees of the New York City Municipal Water Finance Authority and bonds issued by it as follows:

"Any bonds issued pursuant to this title together with the income therefrom shall be exempt from taxation except for transfer and estate taxes. The revenues, moneys and all other property and activities of the authority shall be exempt from all taxes and governmental fees or charges, whether imposed by the state or any municipality, including without limitation real estate taxes, franchise taxes, sales taxes or other excise taxes. The state hereby covenants with the purchasers and with all subsequent holders and transferees of bonds issued by the authority

pursuant to this title, in consideration of the acceptance of and payment for the bonds, that the bonds of the authority issued pursuant to this title and the income therefrom shall be free from such taxation, as aforestated herein, and that all revenues, moneys, and other property pledged to secure the payment of such bonds shall at all times be free from such taxes as aforestated herein."

Laws of 1991 (ch 166, § 22) provided the following explanation for the 1991 amendment:

"Legislative intent. The purpose of sections twenty-two through thirty-six of this act is to make it unquestionably clear and reaffirm that, in accordance with general, longstanding state policy relating to obligations of the state and its agencies, entities, authorities and political subdivisions, the obligations of the specific authorities enumerated in this act⁹ which have been created under the public authorities law and the interest on such obligations have always been subject to indirect taxation, including state and local franchise, estate, gift and transfer taxation. Federal law generally prohibits more favorable treatment for state or local tax purposes of state or local obligations or state-created entity obligations than that accorded federal obligations. Therefore, the legislature (1) declares that the intention of the legislature in enacting the statutes empowering the herein enumerated authorities to issue certain obligations and mentioning in such statutes the exemption from franchise taxes was solely that the operation of such authorities so enumerated would be exempt from franchise taxes, in contrast to any exemption or exclusion from any franchise taxes with respect to entities which might hold such obligations; (2) declares that it has never been a legislative intent to enact a tax exemption for obligations of such authorities so enumerated which would render any state or local indirect tax on interest income therefrom discriminatory with respect to federal obligations; and (3) finds that the obligations of such authorities so enumerated were not sold on any official representation to purchasers that interest income deriving from such obligations would not be included in the measure of franchise taxes on such holders. In any event, the aforementioned sections, including the effective date thereof, makes it clear and reaffirms that the tax exemption with respect to such obligations of such authorities so enumerated and the interest income thereon, from inception, related solely to direct taxation."

Consequently, pursuant to Public Authorities Law § 1045-u.3, bonds (and interest earned thereon) of the New York City Municipal Water Finance Authority were not exempted from franchise taxes and, as a result,

obligations of the United States were not treated in a discriminatory fashion. Therefore, petitioner properly included interest from Federal obligations in the measurement of its entire net income for each of the years at issue and, for the years 1985 through 1987, it properly

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See footnote "6" for a listing of the specific authorities.

included the value of Federal obligations in the measurement of its taxable assets.¹⁰

E. Since there is no jurisdiction to determine Issue I, Issue II also may not be addressed since it becomes ripe for determination only if Public Authorities Law § 1045-u.3 is declared unconstitutional on its face. The instruction by the Tax Appeals Tribunal in matters like Matter of Bleistein (August 11, 1994) that Administrative Law Judges may not "moot"

issues does not alter this analysis because the reason Issue II may not be addressed relates to jurisdictional limitations.

F. Tax Law § 1453(e)(11)(i) allows as a deduction, in determining the entire net income of a banking corporation, "seventeen percent of interest income from subsidiary capital."¹¹

G. Tax Law § 1450 provides the following definitions of "subsidiary" and "subsidiary

¹⁰While this matter was pending, the declaratory judgment action in Astoria Federal Savings and Loan Assn. v. State of New York, as noted in footnote "2", was decided by Judge Marvin E. Segal in the Division's favor on the basis that Public Authorities Law § 1045-u.3, as originally enacted in 1984, did not exempt the bonds or the income therefrom from inclusion in a corporate bondholder's capital or total net income for purposes of calculating the corporation's State and City franchise tax obligations (Astoria Federal Savings and Loan Assn. v. State of New York, Index No. 93-006014 [Sup Ct, Nassau County, August 29, 1994]). Judge Segal decided that the statute, as originally enacted in 1984, was unclear and ambiguous as a result of inartful draftsmanship so that legislative intent could be considered:

"No proof whatsoever has been adduced of any legislative intent to depart from 50 years of precedent which included the income paid by revenue bonds issued by a State public authority in the measure of a corporate bondholder's total net income for purposes of calculating the corporation's franchise tax obligation.

"The construction of PAL 1196-1.3 and PAL 1045-u.3 adopted by the 'Tax Department' is rational and in accord with the legislative intent underlying the promulgation of the 1984 legislation" (Astoria Federal Savings and Loan Assn. v. State of New York, slip op at 18).

¹¹Pursuant to Laws of 1985 (ch 298) this deduction "shall not apply to corporations other than savings banks and savings and loan associations for taxable years beginning on or after January 1, 1994."

capital":

"(d) The term 'subsidiary' means a corporation or association of which over fifty percent of the number of shares of stock entitling the holders thereof to vote for the election of directors or trustees is owned by the taxpayer.

"(e) The term 'subsidiary capital' means investments in the stock of subsidiaries and any indebtedness from subsidiaries"

H. The current regulations concerning franchise tax on banking corporations at 20 NYCRR 16-2.22 provide the following definition of "subsidiary", in relevant part:

"(a) The term subsidiary means a corporation over 50 percent of the voting stock of which is owned by the taxpayer [emphasis in original]

"(b) The test of ownership is actual beneficial ownership, rather than mere record title as shown by the stock books of the issuing corporation. Actual beneficial ownership of stock does not mean indirect ownership or control of a corporation through a corporate structure consisting of several tiers and/or chains [emphasis added]"

The above regulation became effective January 19, 1994. If it were to be applied retroactively to the years at issue, petitioner clearly would not be allowed to deduct 17% of the interest received from indirect subsidiaries

because the current regulation's requirement, that actual beneficial ownership of stock necessitates direct ownership, is not inconsistent with the statutory definition cited above (cf., Matter of Sterling Bancorp, Tax Appeals Tribunal, November 18, 1993).

I. However, the current regulation may not be applied retroactively to the years at issue because it narrowed the definition of subsidiary to exclude a corporation owned indirectly through a corporate structure consisting of several tiers (cf., Matter of Cortelco, Tax Appeals Tribunal, October 31, 1991). The broader definition of subsidiary, which would include a corporation indirectly owned, was validated by the Tax Appeals Tribunal in Matter of The Racal Corporation and Decca Electronics (supra). In its decision, the Tribunal interpreted the following regulatory definition of "subsidiary"¹² then in effect, which was effective for all

¹²The Tribunal analyzed 20 NYCRR 3-6.2 which was the definition of subsidiary under the business corporation franchise tax regulations. However, the same language at issue was then in effect in the regulations concerning franchise tax on banking corporations at 20 NYCRR 2.22(b).

taxable years beginning on or after January 1, 1976:

"(a) The term subsidiary means a corporation which is controlled by the taxpayer, by reason of the taxpayer's ownership of more than 50 percent of the total number of the shares of stock of such corporation, issued and outstanding, which entitle the holder of the shares to vote at elections of its directors or trustees

"(b) The test of ownership is actual beneficial ownership, rather than mere record title as shown by the stock books of the issuing corporation. A corporation will not be considered to be a subsidiary because more than 50 percent of the shares of its voting stock is registered in the taxpayer's name, unless the taxpayer is the actual beneficial owner of such stock. However, a corporation will not be considered a subsidiary if more than 50 percent of the shares of its voting stock is not registered in the taxpayer's name, unless the taxpayer submits proof that it is the

actual beneficial owner of such stock" (20 NYCRR former 3-6.2; emphasis in original).

In a narrow decision, the Tribunal explicitly stated that its decision was an interpretation of this regulation, not an interpretation of the statutory provision:

"The Administrative Law Judge's determination and our affirmance only hold that where a corporation controls all aspects of a second tier subsidiary's operation and management that this is beneficial ownership within the meaning of the regulation" (Matter of The Racal Corporation and Decca Electronics, supra).

J. Consequently, in the matter at hand it must be determined whether petitioner controlled all aspects of the operation and management of the indirect subsidiaries listed in Finding of Fact "13". Petitioner has failed to prove that it did so. In this regard, petitioner's proof is minimal as noted in Finding of Fact "14". The situation at hand is quite different from that in Matter of The Racal Corporation and Decca Electronics (supra) where the Division stipulated that the taxpayer therein had the following control over the indirect subsidiaries at issue:

- (i) Absolute control over the election and removal of officers and directors;
 - (ii) Absolute control over all operational, tax and financial matters;
 - (iii) Absolute power to cause dividends to be declared and paid;
 - (iv) Absolute right to sell or pledge all stock of the subsidiaries; and
 - (v) Absolute power to maintain a shareholder derivative action.
-

In particular, the description of petitioner in the S.E.C. registration statement quoted at length in Finding of Fact "1" raises significant questions concerning the amount of control petitioner possessed over its subsidiaries in the highly regulated banking world. For example, it is doubtful that petitioner controlled all aspects of the operation and management of BT Bank of Canada, reasonably assumed to be a foreign corporation. In short, petitioner has failed to bear the burden of showing entitlement to a deduction (cf., Matter of Mod Maid Imports, Tax Appeals Tribunal, December 30, 1993).

K. The petition of Bankers Trust New York Corporation is denied, and the denials of its refund claims dated October 31, 1990, March 8, 1991 and January 29, 1992 are sustained.

DATED: Troy, New York
November 3, 1994

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE